No. 12826

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

LAWRENCE BARKER,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

On Appeal From the United States District Court for the Southern District of California.

REPLY TO POINTS MADE IN PETITION OF THE UNITED STATES FOR REHEARING.

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TABLE OF AUTHORITIES CITED.

Cases

Statutes

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To the Honorable, the United States Court of Appeals for the Ninth Circuit:

The appellant herein, by and through his attorneys of record, in accordance with the Order of the Court made on September 18, 1952, granting the petition of the appellee herein for rehearing, hereby replies to the points made by the appellee in its petition for rehearing.

I.

This Court, in its original Opinion, correctly stated, as to the basis of the Barker Delaware stock to the Lawrence Barker interests, that "if no subdivision of Section 112(b) to (e) is applicable, then the basis of the Barker

Delaware stock is stepped up to its 1923 market value . . . per share" and "the basis of the Securities Company stock would . . . be $219.35" per share. (Slip Op. 8.) It is respectfully submitted that the Court also correctly concluded that no subdivision of Section 112(b) to (e) of the Internal Revenue Code, the Revenue Act of 1934, or the Revenue Act of 1932, is applicable in this case to determine the basis of the Barker Delaware stock to the Lawrence Barker interests.

If the Court erred, as averred by appellee in its petition for rehearing, in referring solely to the provisions of Section 112(g) of the Internal Revenue Code for the definition of "reorganization" referred to in Section 112(b)(3), it is nevertheless true that the same conclusion as reached by the Court would follow from application of the provisions of Section 112(g) of the Revenue Act of 1934, which defines "reorganization" in terms substantially the same as does the Internal Revenue Code.

The enactment of the Internal Revenue Code did not bring about substantive changes in the definition of "reorganization" or in the provisions to be applied in determining "basis." Thus reference to the various provisions governing basis, included in the Internal Revenue Code, should include consideration of Section 113(a)(16), incorporated in the Code, which was originally enacted as part of the Revenue Act of 1936.

Section 113(a)(16) states:

> *"If the property was acquired, after February 28, 1913, in any taxable year beginning prior to January 1, 1936,* and the basis thereof, for the purposes of the Revenue Act of 1934 was prescribed by Section 113(a)(6), (7), or (8) of such Act, then for the

purposes of this chapter the basis shall be the same as the basis therein prescribed in the Revenue Act of 1934." (Emphasis added.)

Congress made no apparently visible distinction between acquisitions to be governed by Section 113(a)(16), newly enacted in the Revenue Act of 1936, and acquisitions formerly governed in precisely the same manner by Section 113(a)(12) of the Revenue Act of 1934. Though the latter Section was reenacted as part of the Revenue Act of 1936, a thorough search has uncovered no Committee Report dealing with this or with the enactment of Section 113(a)(16) of the Revenue Act of 1936, and it is, therefore, respectfully suggested that this most recent enactment which is in plain terms applicable to acquisitions "after February 28, 1913, in any taxable year beginning prior to January 1, 1936," should govern the acquisition of the Barker Delaware stock by the Lawrence Barker interests. (See *Forstmann v. Rogers* (C. C. A. 3rd, 1942), 128 F. 2d 126.)

If Section 113(a)(16) of the Internal Revenue Code, originally enacted as Section 113(a)(16) of the Revenue Act of 1936, is to be applied to this case, then Section 113(a)(6) of the Revenue Act of 1934, rather than Section 113(a)(6) of the Revenue Act of 1932, is to be applied to determine the basis of the Barker Delaware stock. Appellant respectfully submits that the reasoning applied by the Court in the *Forstmann* case, *supra,* to a comparable situation involving earlier years, is authority for the conclusions herein stated. Accordingly, the result would be the same as already stated by this Court in its original Opinion. For the definition of "reorganization," contained in Section 112(g) of the Revenue Act

of 1934, is, as stated hereinabove (for the purposes of this case), the same as the definition of "reorganization" in the Internal Revenue Code, which was applied to this case by the Court in its original Opinion.

II.

If the propositions advanced by appellee in its petition for rehearing are hypothetically assumed to be correct, nevertheless they fail to state completely the law which would then be applicable to this case.

Section 113(a)(6) of the Revenue Act of 1932, referred to by appellee, states:

> "If the property was acquired upon an exchange described in Section 112(b) to (e), inclusive, the basis shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made . . ."

As stated by the Court in its original Opinion,

> ". . . if any subdivision of section 112(b) to (e) of the law . . . describes the transaction between Barker California and Barker Delaware, further reference must be made to the tax law as it stood in 1923, the year of the transfer, to determine whether or not any gain in the value of Barker California stock was recognized in that year since the basis of Barker Delaware would be the same as that of Barker California, plus the amount of any gain . . . recognized in 1923." (Slip Op. 8.)

Section 202(c) of the Revenue Act of 1921, as amended by Act of March 4, 1923, effective January 1, 1923, states:

> ". . . ; but when the property is exchanged for property specified in paragraphs (1), (2), and (3) of subdivision (c) as received in exchange, together with money or other property of a readily realizable market value other than that specified in such paragraphs, the amount of gain resulting from such exchange shall be computed in accordance with subdivisions (a) and (b) of this section, but in no such case shall the taxable gain exceed the amount of the money and the fair market value of such other property received in exchange."

The general rule covering recognition of taxable gain from exchanges of property has been the same under all revenue acts and the Code: Gain is recognized to the extent of the excess of the fair market value of the property received on the exchange over the cost or other basis of the property exchanged. The exception to this rule, pertinent to this case and to the point presently discussed, is found in Section 202(c)(2) of the Revenue Act of 1921, which provides for nonrecognition of gain if "in the reorganization of one or more corporations a person receives in place of any stock or securities owned by him, stock or securities in a corporation a party to or resulting from such reorganization; . . ." However, Section 202(e), *supra,* is an exception to the exception, and to the extent applicable dictates that taxable gain shall be recognized. This is one of the so-called "boot" provisions, also found in all of the revenue acts since the Revenue

Act of 1921, clearly for the purpose of limiting the non-recognition of gain in technically reorganization type cases which also contain elements of sales rather than merely readjustment of corporate interests.

This Court has correctly observed that the "plan which was agreed upon and carried out in the instant case contemplated one group's ending up with control of the new corporation and the other group's getting an investment interest represented by preferred stock, at least part of which was under a sales-option contract to a third group." (Slip Op. 12.)

The plan of reorganization of Barker Delaware definitely provided for the receipt by the Lawrence Barker interests of cash in place of the entire $2,087,000 first preferred shares to be issued to the Lawrence Barker interests. Said shares were sold for cash pursuant to the plan. The sale of said shares was not a separate step to be viewed apart from the reorganization itself. As this Court stated in its original opinion:

> "Where, as here, the parties to a transaction formulated a plan which contemplated several steps to accomplish the end result, and bound themselves by contract to carry out the plan, the actions taken constitute a single transaction." (Slip Op. 11.)

Thus, even if the propositions advanced by appellee be hypothetically viewed as correct, the property received by the Lawrence Barker interests in exchange for their Barker California stock, insofar as it was temporarily represented by $2,087,000 first preferred shares of Barker Delaware subject to the sales-option contract in favor of Bankers, consisted in reality of cash or its equivalent, not permitted to be received by them without recognition

of taxable gain. (*First Seattle Dexter Horton Nat. Bank, et al. v. Commissioner* (C. C. A. 9th, 1935), 77 F. 2d 45; *Henry Hudson v. Commissioner,* 39 B. T. A. 1075, 1094 (Acq. 1939-2 C. B. 18).) (See also Br. for Appellant 18-32; Reply Br. for Appellant 18-20.)

It is respectfully submitted, therefore, that if appellee's view of the case is correct, it is nevertheless true, as stated by the Court, in its original Opinion:

> "In such circumstances, the parties to the transaction received substantially different property in exchange for their original holdings. Therefore a gain . . . was recognizable on the exchange at that time." (Slip Op. 12.)

As stated by the Court in *Banner Machine Co. v. Routzahn* (C. C. A. 6th, 1949), cert. den. 309 U. S. 676, 107 F. 2d 147, 149,

> "It is true that . . ., stock was received; but the purpose to reduce that stock to cash was clearly shown by the giving of the option to the underwriter for the sale of the stock prior to the receipt thereof. Appellant in effect discounted the stock for cash."

Since the Lawrence Barker interests had recognizable gain from the exchange of their Barker California stock in 1923, even under appellee's view of this case, and since the basis of the Securities Company stock issued to the Lawrence Barker interests is the same as the basis of the assets transferred to the Securities Company for the issuance of its stock (Slip Op. 7), that basis must nevertheless be at least $3,413,081.86, even if all of the statements averred by appellee be taken as correct. This follows from the application of the law discussed above to the facts of this case as will now be shown.

The basis of $3,413,081.86 for the assets transferred to the Securities Company is arrived at as follows: (a) $1,326,081.86, the basis of the Barker California shares owned by the Lawrence Barker interests [R. 32], plus $2,087,000, the recognized taxable gain to the Lawrence Barker interests upon the exchange under the law applicable to 1923, minus $2,087,000, the amount of money received; plus (b) $2,087,000, the money received, which, however, was a part of the assets transferred to the Securities Company for the issuance of its stock.

Applying the foregoing, appellant's basis for his Securities Company stock becomes at least $156.50 per share: $235,031.57, appellant's basis for his Barker California stock [R. 32] plus $469,847.77, which is 1841.50/8179.69 of $2,087,000 (appellant's share of the money received); or $704,879.34; divided by 4504.13, which is the number of Securities Company shares issued to appellant [R. 28].

III.

The position contended for by appellant throughout this proceeding, namely, that the Lawrence Barker interests had recognizable gain from the exchange of their Barker California stock in 1923, clearly includes the lesser propositions set forth herein. Whether the ultimate decision in this case be that the recognized gain in 1923, $3,060,918.14, was the entire gain realized, resulting in a basis for appellant's Securities Company stock of $219.35 per share; or was a portion thereof, $2,087,000 (as set forth hereinabove), resulting in a basis for appellant's Securities Company stock of $156.50 per share; the basic contention of appellant that gain was recognized upon the 1923 exchange is the same.

The foregoing was not discussed in the Brief for Appellant since that brief was limited to the questions decided by the lower court under Section 112(b)(5). Similarly, this was not discussed in the Reply Brief for Appellant since it did not appear to appellant's attorneys as relevant to the points argued by appellee in its Brief herein. The points made herein, however, it is respectfully submitted, are clearly appropriate to the pending disposition of this case by this Court if the Court should decide not to reinstate its original decision and to adhere to its view that this case is not governed by the *Groman* doctrine and the decisions involving reorganizations cited in the Reply Brief for Appellant on file herein. (*Starr v. Commissioner* (C. C. A. 4th, 1936), 82 F. 2d 964, 967, cert. den. 298 U. S. 680.)

Wherefore, appellant prays that this Honorable Court reinstate its original decision and reverse the decision of the District Court.

October, 1952.

Respectfully submitted,

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